

the authority to conduct operations and make investments outside the United States only through gradually adopting a series of specific statutory amendments to the Federal Reserve Act, each of which has been carefully drawn to give the Board approval, supervisory, and regulatory authority over those operations and investments.

(d) As part of the original Federal Reserve Act, national banks were, with the Board's permission, given the power to establish foreign branches.² In 1916, Congress amended the Federal Reserve Act to permit national banks to invest in international or foreign banking corporations known as *Agreement Corporations*, because such corporations were required to enter into an agreement or understanding with the Board to restrict their operations. Subject to such limitations or restrictions as the Board may prescribe, such Agreement corporations may principally engage in international or foreign banking, or banking in a dependency or insular possession of the United States, either directly or through the agency, ownership or control of local institutions in foreign countries, or in such dependencies or insular possessions of the United States. In 1919 the enactment of section 25(a) of the Federal Reserve Act (the "Edge Act") permitted national banks to invest in federally chartered international or foreign banking corporations (so-called Edge Corporations) which may engage in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States, either directly or through the ownership or control of

local institutions in foreign countries, or in such dependencies or insular possessions. Edge Corporations may only purchase and hold stock in certain foreign subsidiaries with the consent of the Board. And in 1966, Congress amended section 25 of the Federal Reserve Act to allow national banks to invest directly in the shares of a foreign bank. In the Board's judgment, the above statutory scheme of the Federal Reserve Act evidences a clear Congressional intent that member banks may only purchase and hold stock in subsidiaries located outside the United States through the prescribed statutory provisions of sections 25 and 25(a) of the Federal Reserve Act. It is through these statutorily prescribed forms of organization that member banks must conduct their operations outside the United States.

(e) To summarize, the Board has concluded that a member bank may only organize and operate *operations subsidiaries* at locations in the United States. Investments by member banks in foreign subsidiaries must be made either with the Board's permission under section 25 of the Federal Reserve Act or, with the Board's consent, through an Edge Corporation subsidiary under section 25(a) of the Federal Reserve Act or through an Agreement Corporation subsidiary under section 25 of the Federal Reserve Act. In addition, it should be noted that bank holding companies may acquire the shares of certain foreign subsidiaries with the Board's approval under section 4(c)(13) of the Bank Holding Company Act. These statutory sections taken together already give member banks a great deal of organizational flexibility in conducting their operations abroad.

(Interprets and applies 12 U.S.C. 24, 335)

[40 FR 12252, Mar. 18, 1975]

§ 250.160 Federal funds transactions.

(a) It is the position of the Board of Governors of the Federal Reserve System that, for purposes of provisions of law administered by the Board, a transaction in Federal funds involves a loan on the part of the *selling* bank and a borrowing on the part of the *purchasing* bank.

(b) For example, for purposes of section 23A of the Federal Reserve Act (12

²Under section 9 of the Federal Reserve Act, State member banks, subject, of course, to any necessary approval from their State banking authority, may establish foreign branches on the same terms and subject to the same limitations and restrictions as are applicable to the establishment of branches by national banks (12 U.S.C. 321). State member banks may also purchase and hold shares of stock in Edge or Agreement Corporations and foreign banks because national banks, as a result of specific statutory exceptions to the stock purchase prohibitions of section 5136, can purchase and hold stock in these Corporations or banks.

U.S.C. 371c), a *sale* of Federal funds by a member bank, whether State or national, to an affiliate of the member bank is subject to the limitations prescribed in that section.

(12 U.S.C. 371c)

§ 250.161 Capital notes and debentures as “capital,” “capital stock,” or “surplus.”

(a) The Board of Governors has been presented with the question whether capital notes or debentures issued by banks, that are subordinated to deposit liabilities, may be considered as part of a bank’s *capital stock*, *capital*, or *surplus*, for purposes of various provisions of the Federal Reserve Act that impose requirements or limitations upon member banks.

(b) A *note* or *debenture* is an evidence of debt, embodying a promise to pay a certain sum of money on a specified date. Such a debt instrument issued by a commercial bank is quite different from its *stock*, which evidences a proprietary or *equity* interest in the assets of the bank. Likewise, the proceeds of a note or debenture that must be repaid on a specified date cannot reasonably be regarded as *surplus funds* of the issuing corporation.

(c) Federal law (12 U.S.C. 51c) expressly provides that the term *capital*, as used in provisions of law relating to the capital of national banks, shall mean “the amount of unimpaired common stock plus the amount of preferred stock outstanding and unimpaired.” In addition, when Congress in 1934 deemed it desirable to permit certain notes and debentures—those sold by State banks to the Reconstruction Finance Corporation—to be considered as *capital* or *capital stock* for purposes of membership in the Federal Reserve System, Congress felt it necessary to implement that objective by a specific amendment to section 9 of the Federal Reserve Act (12 U.S.C. 321). These plain evidences of Congressional intent compel the conclusion that, for purposes of statutory limitations and requirements, *capital* notes and debentures may not properly be regarded as part of either *capital* or *capital stock*.

(d) Accordingly, under the law, capital notes or debentures do not constitute *capital*, *capital stock*, or *surplus*

for the purposes of provisions of the Federal Reserve Act, including, among others, those that limit member banks with respect to purchases of investment securities (12 U.S.C. 24, 335), investments in bank premises (12 U.S.C. 371d), loans on stock or bond collateral (12 U.S.C. 248(m)), deposits with non-member banks (12 U.S.C. 463), and bank acceptances (12 U.S.C. 372, 373), as well as provisions that limit the amount of paper of one borrower that may be discounted by a Federal Reserve Bank for any member bank (12 U.S.C. 84, 330, 345).

(12 U.S.C. 24, 84, 248, 321, 330, 335, 345, 371c, 371d, 372, 373, 463)

[33 FR 9866, July 10, 1968, as amended at 61 FR 19806, May 3, 1996]

§ 250.162 Undivided profits as “capital stock and surplus”.

(a) The Board of Governors has reexamined the question whether a member bank’s undivided profits may be considered as part of its *capital stock and surplus*, as that or a similar term is used in provisions of the Federal Reserve Act that limit member banks with respect to the following: Purchases of investment securities (12 U.S.C. 335), loans on stock or bond collateral (12 U.S.C. 248(m)), deposits with nonmember banks (12 U.S.C. 463), bank acceptances (12 U.S.C. 372, 373), investments in and by Edge and Agreement corporations (12 U.S.C. 601, 615, 618), and the amount of paper of one borrower that may be discounted or accepted as collateral for an advance by a Federal Reserve Bank (12 U.S.C. 330, 345, 347).

(b) Upon such reexamination the Board concludes that its negative view expressed in 1964 is unnecessarily restrictive in the light of the Congressional purpose in establishing limitations on bank activities in terms of a bank’s capital structure. Accordingly, the Board has decided that, for the purposes of the limitations set forth above, undivided profits may be included as part of *capital stock and surplus*.

(c) As used herein, the term *undivided profits* includes paid-in or earned profits (unearned income must be deducted); reserves for loan losses or bad debts, less the amount of tax which would become payable with respect to